

ST 03-0180-GIL 11/17/2003 CONSTRUCTION CONTRACTORS

This letter discusses the tax liabilities of sellers of floor coverings. See 86 Ill. Adm. Code 130.2101. (This is a GIL).

November 17, 2003

Dear Xxxxx:

This letter is in response to your letter dated November 15, 2002. We apologize for the delay in responding to your inquiry. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found on the Department's Internet website at <http://www.revenue.state.il.us/Laws/regs/part1200/>.

In your letter, you have stated and made inquiry as follows:

This request for an expedited General Information Letter is submitted pursuant to the authority of 2 Ill. Admin. Code 1200.120, on behalf of AAA for the benefit of its members.

We have been asked by the AAA to request guidance on three scenarios encountered by Association members. These are as follows:

1. A seller of floor coverings, including but not limited to carpeting, who installs the floor coverings it sells, customarily reports its use tax liability as a construction contractor, but does make retail sales. For the transactions that are the subject of this ruling request, the seller affixes the floor coverings to the building with cement or by the use of tacks, staples or tacking strips. The seller responds to a request for proposals (RFP) with a bid that, pursuant to the requirement of the RFP, sets out the selling price of the floor covering per square foot and the installation charge per square foot. The contract for installation of the floor coverings will contain the per square foot charge for the floor coverings, the per square foot charge for installation and will be signed by the customer. The seller purchases its materials tax free by giving a resale certificate pursuant to the authority of 86 Ill. Admin. Code Sec. 130.2075(b).

The information contained in the bid and contract would seem to meet the safe harbor requirements for retail sales contained in 86 Ill. Admin. Code Sec. 130.2101(c)(2) (A), yet the seller wishes to treat the contract as a construction contract and self assess tax (including any applicable local tax) on its cost price, as opposed to selling price, of materials, as provided for by 86 Ill. Admin. Code 130.2075(b)&(c).

Guidance is requested as to whether the terms of the bid and contract will bind the seller to the provisions of the safe harbor treatment for retail sales provided for by 86 Ill. Admin. Code Sec. 130.2101(c)(2)(A), and, if not, what substantiation will be required to show the character of the contracts as construction contracts.

2. A seller of floor coverings, including but not limited to carpeting, who installs the floor coverings it sells, customarily reports its use tax liability as a construction contractor pursuant to the provisions of 86 Ill. Admin. Code Sec. 130.2101(c)(2)(A) or 130.2075(b) or (c). The seller affixes the floor coverings to the building with cement or by the use of tacks, staples or tacking strips. The seller enters into an agreement with an interior designer, which provides that the seller will bill the interior designer who will contract with the property owner for the sale of floor coverings and installation. The seller purchases its materials tax free by giving a resale certificate pursuant to the authority of 86 Ill. Admin. Code Sec. 130.2075(b) because at the time of the purchase of inventory it does not know if the materials will be used performing a construction contract or sold at retail.

The interior designer is registered with the Department as a retailer or reseller and wishes to give the seller a resale certificate. The contract between the seller and interior designer can provide the information required to meet the safe harbor requirements of 86 Ill. Admin. Code Sec. 130.2101(c)(2)(A) for a retail sale, except there would ordinarily be no sales tax shown because the sale is for resale. The contract between the interior designer and the property owner can contain the information required to meet the retail sale safe harbor requirements.

Guidance is requested as to whether the safe harbor for retail sales provided for by 86 Ill. Admin. Code Sec. 130.2101(c)(2)(A) is available when the seller/installer of floor coverings is making a sale for resale (a wholesale sale) or if there is any special requirement for resale certificates in this situation. If the safe harbor for retail sales is not available, will the transaction necessarily be a construction contract, or, if not, what documentation or substantiation is required to establish the sale as a sale for resale?

3. A seller of floor coverings, including but not limited to carpeting, both installs floor coverings and makes retail sales of floor coverings 'over the counter' or by utilizing the safe harbor provided for by 86 Ill. Admin. Code Sec. 130.2101(c)(2)(A). The seller purchases its materials tax free by giving a resale certificate pursuant to the authority of 86 Ill. Admin. Code Sec. 130.2075(b).

Purchases of floor coverings from out-of-state vendors are subject to the Use Tax, not to the Retailers' Occupation Tax. Purchases of floor coverings from Illinois Retailers are subject to the Retailers' Occupation Tax. Where sellers of floor coverings properly purchase all inventory sales tax free they must 'reconstruct' the purchase later when they engage in 'construction contracts,' either under the safe harbor of 86 Ill. Admin. Code Sec. 130.2101(d)(1), or under the provisions of 86 Ill. Admin. Code Sec. 1940(c).

The seller purchases what is basically fungible inventory from various vendors. Certain vendors may have more than one location at which purchase orders are accepted or where orders are filled from inventory, either within or without the state of Illinois. Additionally, orders are frequently made either by telephone or internet and the seller (installer) may not know where the purchase order is accepted or where the order is filled from inventory.

When acting as a construction contractor and the floor coverings are purchased from out-of-state, the applicable tax base is the cost price and the applicable tax is the Use Tax pursuant to 86 Ill. Admin. Code Sec. 130.2075(c). Alternatively, pursuant to 86 Ill. Admin. Code Sec. 130.2075(b)(2), a construction contractor who purchases materials tax free from a vendor in the State of Illinois and who subsequently incorporates these materials into real estate, must report ROT, including applicable local tax, upon his cost price.

The problem is that it may not be possible to ascertain whether a supplier is an Illinois Retailer or if the source of the floor coverings is within the State of Illinois.

Guidance is requested concerning substantiation requirements for the situs of purchases of fungible goods, such as floor coverings, incorporated into real estate. Guidance is also requested regarding the seller's liability should either Use Tax or ROT be paid in error. Will the seller be allowed a credit against its true Use Tax or ROT liability if it reports and pays either Use Tax or ROT in error? Specifically, will the seller be liable for only any additional local ROT tax if its purchase was from an in-state vendor and the only tax it self-assesses is Use Tax. Conversely, will the seller be liable for additional Use Tax if it self assesses ROT on its cost price of the floor coverings purchased from an out-of-state vendor?

Thank you for your consideration of these issues. If you would like to discuss these issues or need further information, please contact me.

#### **DEPARTMENT'S RESPONSE:**

Sellers who make sales of floor coverings to users in retail sale situations incur Retailers' Occupation Tax liability on their gross receipts from such sales. In retail sale situations, the seller should provide certificates of resale to suppliers and pay Retailers' Occupation Tax on his gross receipts from sales. See subsection (a) of 86 Ill. Adm. Code 130.2101.

Sellers who make sales of floor coverings to users in construction contract situations incur tax liability on the cost price of the floor coverings. See subsection (b) of Section 130.2101. If the construction contractor purchases the floor covering and materials from an out-of-state supplier not registered to collect Illinois tax, then the construction contractor must pay Use Tax directly to the Department. See subsection (d)(3) of Section 130.2101. If the construction contractor is a combination contractor/retailer and did not pay tax when purchasing the floor coverings and materials from an Illinois supplier by giving a certificate of resale to that supplier, the construction contractor incurs Retailers' Occupation Tax based on his cost price of the floor coverings and materials. See subsection (d)(4) of Section 130.2101.

For further information about when carpeting is permanently affixed as real estate, see subsection (c)(1) of 86 Ill. Adm. Code 130.1940. As explained in the regulation, permanent affixation of floor coverings includes those installed by use of tacks, staples, or wood stripping filled with nails that protrude upward (sometimes referred to as "tacking strips" or "tack down strips"). However, permanent affixation does not include floor coverings that are area rugs or that are attached to the structure using only two-sided tape.

Subsection (c) of Section 130.2101 describes retail sale situations. In general, a sales contract that does not require the seller (or the seller's representative) to permanently affix the floor

covering to real estate constitutes a “sale at retail.” However, in some situations, the seller (or seller’s representative) will permanently affix the floor covering to real estate. In that case, the transaction remains a retail transaction if the “safe harbor” rule is followed. The “safe harbor” rule provides that

**Safe Harbor Rule.** A contract or similar document that provides that the seller (or the seller's representative) will install the floor covering by permanently affixing it to real estate evidences a "sale at retail" where the contract or similar document demonstrates that the seller and the customer agreed to the installation charge separately from the selling price of the floor covering. The evidence required to be maintained by the seller to demonstrate that the seller and the customer agreed to the installation charge separately from the selling price of the floor covering is a contract or similar document that is signed by the customer and that sets out the following items:

selling price of floor covering  
(plus) sales tax  
subtotal

(plus) installation charges

total

(customer's signature)

Subsection 130.2101(d) describes construction contract situations. Construction contractors who permanently affix floor coverings to real estate under the terms of construction contracts incur tax liability based on their cost price of the floor covering and materials that they affix to real estate. In a construction contract situation, the construction contractor does not incur Retailers' Occupation Tax liability on his gross receipts from sale. Rather, the construction contractor incurs tax based on his cost price of the floor covering and materials transferred to his customer under the terms of the construction contract. The "safe harbor" rule with regard to construction contract situations provides that:

Safe Harbor Rule. A contract or similar document that provides that the seller (or the seller's representative) will install the floor covering by permanently affixing it to real estate evidences a "construction contract" where the contract or similar document demonstrates that the seller and the customer did not agree to the installation charge separately from the selling price of the floor covering. The evidence required to be maintained by the seller to demonstrate that the seller and the customer did not agree to the installation charge separately from the selling price of the floor covering is a contract or similar document that sets out the following items:

	selling price of floor covering,
	including installation
	total

(presence or absence of customer's signature is immaterial)

In the first specific situation you have inquired about, both the request for proposal and contract between the seller and the customer provide for a separate charge for installation. This scenario does appear to meet the safe harbor provisions of subsection (c) of Section 130.2101

depending upon how that information is presented in the actual contract. In general, a contract that sets out separate charges for installation in the same manner as provided in the safe harbor provision contained in subsection (c)(2)(A) of Section 130.2101 will be considered a retail sale and not a construction contract. If the seller wishes to ensure that a transaction will be considered a construction contract, the seller should take care to make sure the contract conforms to the requirements of the safe harbor provision set out in subsection (d)(1) of Section 130.2101.

In the second situation you have inquired about, we are answering your question under the understanding that the flooring seller is not acting as a construction contractor. The flooring seller is making a sale that conforms to the requirements (separately agreed installation charge) of the safe harbor provision set out in subsection (c)(2)(A) of Section 130.2101. In the instance described in your letter, the flooring seller can make a sale for resale of the flooring materials to an interior designer. The flooring seller should obtain a certificate of resale from the interior designer. If the flooring seller fails to obtain a certificate of resale from the interior designer and the contract with the interior designer falls within the safe harbor provision set out in subsection (c)(2)(A) of Section 130.2101, the sale by the flooring seller is presumed to be a taxable sale at retail (not a construction contract). Please note that the flooring seller may rebut the presumption that this is a taxable sale by other evidence that the sale is actually a sale for resale. See subsection (d) of 86 Ill. Adm. Code 130.1405.

In the third situation you have inquired about, we cannot provide you with a specific answer regarding the documentation needed to substantiate an in-State or out-of-State purchase from a supplier. Vendor invoices and copies of purchase orders are generally sufficient to document taxable purchases, whether purchased from an Illinois supplier or from an out-of-State supplier. See 86 Ill. Adm. Code 130.805. If the purchases are from an out-of-State vendor, then only 6.25% Use Tax is incurred. If the purchases are from an in-State vendor, then the purchaser incurs Retailers' Occupation Tax at 6.25% plus and local Retailers' Occupation Tax if applicable. See subsection (b)(2) of 86 Ill. Adm. Code 130.2075. If the seller's records do not clearly reflect whether the purchase was made from an in-State or out-of-State vendor, then the Department's auditors would use their best judgment and information to determine whether Retailers' Occupation Tax (plus any applicable local Retailers' Occupation Tax) or Use Tax is incurred on that specific purchase.

In the context of a General Information Letter, we are unable to answer your hypotheticals regarding overpayments and underpayments of tax. Should specific situations of this type arise outside of an audit, we suggest you contact the Department for issuance of a Private Letter Ruling.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at [www.revenue.state.il.us](http://www.revenue.state.il.us). If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b) described above.

Very truly yours,

Terry D. Charlton  
Associate Counsel

TDC:msk